

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS: 01-0173; 01-0174  
Withholding and Individual Income Tax  
For the Years 1992 through 2000**

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**ISSUES**

**I. Property Tax Expenses.**

**Authority:** IC 6-8.1-5-1(b).

Taxpayer maintains that the audit employed incorrect figures in determining the amount of property tax expenses taxpayer was entitled to deduct from his income derived from the rental of that property.

**II. Entertainment Income.**

**Authority:** IC 6-8.1-5-1(b).

Taxpayer argues that the audit erred in attributing to his income the amount of "cover charges" assessed against tavern patrons on the nights on which live music was provided at one of his taverns.

**III. Additional Payroll Expense – Withholding Taxes.**

**Authority:** IC 6-3-4-8(a); IC 6-3-4-8(f); IC 6-3-4-8(g); IC 6-8.1-5-1(b).

Taxpayer maintains that the audit erred in assessing additional withholding taxes.

**IV. Property Taxes Paid on Personal Residence.**

**Authority:** IC 6-3-1-3.5(a); IC 6-3-1-3.5(a)(17).

Taxpayer argues that he paid property taxes on his personal residence and that he should be permitted to deduct the amount of those property taxes.

## **STATEMENT OF FACTS**

Subsequent to 1991, taxpayer decided to stop filing either federal or state income tax returns. During 2001, taxpayer was audited and assessed individual income tax and additional withholding taxes. Because taxpayer failed to keep complete records, the audit assessed the taxes based upon certain assumptions some of which the taxpayer maintains are erroneous.

Taxpayer received income from the rental of various properties and from the operation of two taverns. Income from the two taverns was derived from the sale of beer, mixed drinks, soft drinks, food, and the operation of gaming machines. In addition, the taxpayer arranged for local bands to provide music at his taverns. On the nights when music was provided, taxpayer imposed a cover charge at one of the taverns.

The taxpayer did not maintain separate accounting records for the two taverns. Taxpayer paid all expenses for both taverns out of one checkbook. Taxpayer did not maintain cash register receipts or any other form of primary documentation that would authoritatively verify the income received from the taverns. Accordingly, the audit made various projections – based upon the cost of goods purchased for use at the taverns – to arrive at a calculation of taxpayer’s income derived from the two taverns.

One of taxpayer’s taverns was operated seven days each week. (Hereinafter “seven-day tavern”). The second tavern was operated only on Thursday, Friday, and Saturday. (Hereinafter “three-day tavern”). Taxpayer maintained that, as sole proprietor, he operated the three-day tavern without any other assistance. Taxpayer further asserts that he hired one person to operate the seven-day tavern on Thursday, Friday, and Saturday. This single employee worked from 5:30 PM to 1:30 AM and received approximately \$3.50 per hour. Taxpayer operated the seven-day tavern the remaining four days each week. Therefore, according to taxpayer, the two taverns were operated with the smallest number of employees physically possible.

According to taxpayer, ASCAP (American Society of Composers, Authors and Publishers) rated the seven-day tavern as accommodating 75 persons. Taxpayer admits that additional patrons could be accommodated. The seven-day tavern offered beer, mixed drinks, food, and soft drinks. In addition, the seven-day tavern provided live music, pool tables, and gaming machines for its patrons.

Except for the pool tables, the three-day tavern offered patrons the same amenities as the seven-day tavern. In addition, the three-day tavern had a 400 square foot dance floor. According to taxpayer, the three-day tavern could accommodate 200 patrons.

## **DISCUSSION**

### **I. Property Tax Expenses.**

In addition to the two taverns, taxpayer owns certain rental properties. Taxpayer claimed as deductible expenses the property taxes associated with those rental properties. Taxpayer argues

that the audit erred in its calculation of the amount of property taxes for the years 1994 through 1999 and has presented figures which increase the amount which taxpayer is entitled to deduct.

The audit's determinations are presumed correct. It is the taxpayer's responsibility to refute the audit's determinations. "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is wrong." IC 6-8.1-5-1(b).

The amount of property taxes paid on taxpayer's rental properties has been calculated and affirmed by taxpayer's accountant based upon primary and authoritative documentation. The taxpayer has met its burden of demonstrating that the proffered property tax figures are correct.

### **FINDING**

Taxpayer's protest is sustained.

## **II. Entertainment Income.**

Taxpayer provided live music at both of his taverns. At the three-day tavern, patrons did not pay a cover charge. Taxpayer paid the bands at the three-day tavern, and the audit allowed those band expenses as a deduction.

At the seven-day tavern, patrons paid a cover charge when live music was provided. According to taxpayer, one of the band members or an associate of the band collected the cover charges and retained the cover charges in their entirety. Those accumulated cover charges represented the exclusive payment received by the bands at the seven-day tavern.

The audit found that the purported cover arrangement at the seven-day tavern lacked credibility and assessed – as income constructively received – additional income taxes on the cover charges received at the seven-day bar.

Subsequent to the administrative hearing, taxpayer arranged to provide evidence establishing that the band members, or their representative, collected the cover charges and that the accumulated cover charges constituted the bands' exclusive payment. This evidence purports to substantiate taxpayer's assertion that the cover charges should not be imputed to the taxpayer as personal income.

Taxpayer has operated the seven-day tavern since 1979. Common sense would dictate that during the 20-some years taxpayer operated the seven-day tavern, bands have performed – and cover charges have been imposed – on numerous occasions. It is undisputed, that taxpayer declined to report any of his income since 1991. Given those circumstances – and in the absence of any substantive evidence documenting the agreements taxpayer had with the bands

performing at the seven-day tavern – the anecdotal information supporting taxpayer’s assertion is insufficient to overcome the presumption imposed under IC 6-8.1-5-1(b).

### **FINDING**

Taxpayer’s protest is respectfully denied.

### **III. Additional Payroll Expense – Withholding Taxes.**

According to taxpayer, only one other person was ever employed to assist in operating the two taverns. That single employee operated the seven-day tavern on Thursdays, Fridays, and Saturdays – the three days on which taxpayer alone operated the three-day tavern.

The audit found this purported arrangement unlikely and assessed additional withholding taxes in the belief that operation of the two taverns required more employees than the number claimed by the taxpayer.

Audit based its calculation on the number of hours the taverns were open, the estimated number of employees required to operate the two taverns, the number of days the two taverns were open each year, and on the estimated hourly wage received by the employees. Based on that calculation, the audit determined that taxpayer spent approximately \$48,000 each year on wages and assessed the additional withholding taxes for 1997, 1998, 1999, and 2000 accordingly.

Taxpayer presents figures to refute the audit’s calculation. Taxpayer asserts that he paid approximately \$14,000 in wages during 2000 and \$42,000 in wages during 2001. Taxpayer provides no information to specifically refute audit’s determinations for 1997, 1998, and 1999 but argues that he should be entitled to extrapolate the available figures for 2000 and 2001 backwards in time to arrive at a more accurate determination of the wages paid during those earlier years.

It is not refuted that taxpayer actually forwarded withholding tax to Indiana during 1997, 1998, and 1999. Based on the amount of withholding taxpayer actually remitted to the state during those three years, taxpayer originally maintained that he paid approximately \$1,800, \$2,800, and \$1,300 in wages during 1997 through 1999.

Every employer paying wages subject to the federal withholding tax is required to withhold, collect, and remit Indiana withholding on the wages paid to its own employees. IC 6-3-4-8(a). Once the employer withholds the tax on wages paid to his employees, the employer holds those taxes in trust for the state. IC 6-3-4-8(f). If the employer should fail to withhold the appropriate amount of taxes, the employer becomes individually liable for the amount of withholding tax which should have been remitted to the state. IC 6-3-4-8(g).

The notice of unpaid withholding tax is prima facie evidence that the Department's claim for the unpaid withholding tax is correct. IC 6-8.1-5-1(b). The burden is on the taxpayer to demonstrate that the Department's claim for the unpaid withholding taxes is incorrect. Id.

Taxpayer apparently failed to submit any withholding taxes before 1997. Taxpayer admits that he had at least one weekly employee working at the seven-day tavern during the years before 1997. For the year 2001 – the first year in which complete records were apparently maintained – taxpayer admits paying wages totaling approximately \$42,000. In contrast, taxpayer originally claimed paying \$1,800, \$2,800, and \$1,300 in wages during 1997 through 1999, an assertion – based on the facts and circumstances surrounding the operation of taxpayer's various business operations – which lacks a certain credibility.

Taxpayer asks the Department to accept the proposition that he was able to simultaneously operate two taverns while employing one other employee who worked alone three nights each week at the seven-day tavern. The single employee – or taxpayer working alone – would have been responsible for preparing and serving food and beverages at taverns which were capable of accommodating up to 200 or more patrons including those nights on which live music was performed. In addition to preparing and serving food and beverages, this single person would have been responsible for performing every other duty ancillary to the operation of the taverns while simultaneously meeting the needs of the patrons. Taxpayer asks the Department to accept the assertion that this work would have been performed by one person without the assistance of another bartender, assistant, clean-up person, host, waiter, or waitress. In addition, taxpayer asks the Department to accept on face value the assertion that he worked alone, seven days a week, each and every day on which either tavern was open for at least the last twelve years. Taxpayer asks too much of the Department.

Taxpayer fails to meet the burden of proof mandated under IC 6-8.1-5-1(b).

### **FINDING**

Taxpayer's protest is respectfully denied.

#### **IV. Property Taxes Paid on Personal Residence.**

Taxpayer argues that he is entitled to claim a deduction against his 1999 state income taxes for the property taxes paid on his personal residence.

The starting point for determining an individual's income tax liability is "adjusted gross income" as defined by I.R.C. § 62. IC 6-3-1-3.5(a). The taxpayer is entitled to make certain deductions from the amount of federal "adjusted gross income" including a deduction for local property taxes. IC 6-3-1-3.5(a)(17). In relevant part that law states as follows:

When used in IC 6-3, the term "adjusted gross income" shall mean the following:

(a) In the case of all individuals, “adjusted gross income” (as defined in Section 62 of the Internal Revenue Code), modified as follows . . .

(17) Subtract an amount equal to the lesser of:

(A) two thousand five hundred dollars (\$2,500): or

(B) the amount of property taxes that are paid during the taxable year in Indiana by the individual on the individual’s principal place of residence.

Taxpayer has provided primary documentation establishing that he paid approximately \$600 in 1999 property taxes. Because taxpayer has met his burden of demonstrating that he paid 1999 property taxes and that those property taxes were paid on his primary residence, taxpayer is entitled to claim the deduction provided under IC 6-3-1-3.5(a)(17).

### **FINDING**

Taxpayer’s protest is sustained.